



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced: **02/22/07**

Bill No: **[AB 1050](#)**

Tax: **Sales and Use**

Author: **La Malfa**

Related Bills:

BILL SUMMARY

This bill would provide a sales and use tax exemption for the following:

1. Any form of animal life used in fiber production, as defined,
2. Feed for any form of animal life used in fiber production, and
3. Drugs or medicines, as specified, administered to animal life used in fiber production.

ANALYSIS

CURRENT LAW

Under the existing Sales and Use Tax Law, the sales or use tax applies to the sale or use of tangible personal property in this state, unless specifically exempted. Under existing law, animals are regarded as tangible personal property, and sales of animals are generally subject to tax. However, Section 6358 of the Sales and Use Tax Law provides a sales and use tax exemption on charges for what are generally referred to as “food animals.” In particular, the sale or use of any form of animal life the kind of which ordinarily constitutes food for human consumption is exempt from tax. A cow, for example, is regarded as a food animal and the sale of a cow is exempt from tax since the products from cows ordinarily constitute food for human consumption. Other animals regarded as “food animals” include sheep, rabbits, swine, chicks, fish, and bees.

In addition, the sale or use of feed for any form of animal life of a kind the products of which ordinarily constitute food for human consumption is also exempt from tax (such as alfalfa for cows), as well as feed for any form of animal life of a kind the products of which are to be sold in the regular course of business (such as feed sold to a person in the business of raising and selling rodents, or feed purchased by a chinchilla farmer where the chinchillas are bred for their pelt).

The sale and use of drugs or medicines, including oxygen, administered to “food animals” is also exempt from sales and use tax when the primary purpose of those drugs or medicines is the prevention or control of disease.

Section 6358.4 also provides a sales and use tax exemption for the sale and use of drugs and medicines, the primary purpose of which is the prevention and control of disease, and administered to “food animals” or animals held for resale when the drug or medicine is administered as an additive through either their feed or water.

PROPOSED LAW

This bill would add Section 6358.3 to the Sales and Use Tax Law to provide a sales and use tax exemption for the following:

1. Any form of animal life used in fiber production
2. Feed for any form of animal life used in fiber production

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3. Drugs or medicines, including oxygen, the primary purpose of which is the prevention or control of disease, that are administered to animal life used in fiber production.

The bill would define “animal life used in fiber production” to mean an animal whose coat, fur, skin, or hair is used to create fibers, including, but not limited to, angora rabbits, llamas, alpacas, angora goats and cashmere goats. The bill would exclude from that term, horses, dogs, cats, monkeys, chinchillas, mink and rodents.

As a tax levy, the bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill is enacted.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. It is intended to provide sales of “fiber animals” the same tax benefits as sales of “food animals.” The author’s office notes the inconsistency in the law with respect to the application of tax to some animals raised for their fibers. As an example, California farmers often raise both angora rabbits and alpacas for fiber production. The sale of an angora rabbit is currently exempt from tax, as rabbits are animals of a kind the products of which ordinarily constitute food for human consumption. Yet, angora rabbits are generally bred for their wool. On the other hand, the sale of alpacas that are generally bred for their wool is subject to tax, since alpacas are not animals regarded as “food animals.” The author’s office sees this as an illogical distinction, and is attempting to put “fiber animals” on equal footing with “food animals” relative to the Sales and Use Tax Law.
2. **Inconsistencies would still exist and could add another level of complexity in tax administration.** The bill would provide an exemption for the sale or purchase of any animal whose coat, fur, skin, or hair is used to create fibers. Yet, an inconsistency would still exist with regard to these animals. For example, it appears an alpaca sold for use as a pet, or for research purposes, would remain subject to tax under the language of the bill. Administration of this exemption could therefore result in complexities in determining whether an animal is ultimately used to create fibers. For ease of administration, a preferable approach would be to exempt any form of animal life, the products of which ordinarily are used to create fiber. In that way, all sales of ordinarily fiber-creating animals, whether or not they ultimately are used to create fibers, would be exempt from tax. The same language should be used for the proposed exemption for feed, drugs and medicines.
3. **Some sales of feed to persons raising “fiber animals” are already exempt from tax.** Currently, while the application of tax to the sale of food animals and the application of tax to the sale of some fiber animals differ (unless they are resold), the application of tax on sales of feed to food animals or nonfood animals which are to be sold in the regular course of business, or the products of which are to be sold in the regular course of business, is the same. Therefore, the sale of feed to an alpaca farmer, for example, used to feed the alpacas from which wool would be sold is exempt from tax to the same extent as the sale of feed to a livestock farmer.
4. **Should the application of tax for “fiber animals” parallel the tax application to “food animals?”** While the inconsistency in the law is recognized, the underlying rationale for the existing exemption for sales of food animals, and feed, drugs and medicines for food animals is that food is a basic necessity of life, and its price

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should not be increased by taxation. Extending this type of exemption to sales of “fiber animals” could be viewed as a far-reaching deviation from this rationale.

5. **Sales of goats and rabbits are already exempt.** The bill specifically lists angora rabbits, angora goats, and cashmere goats within the list of fiber animals that would qualify for the proposed exemption. However, since rabbits and goats are currently regarded as animals of a kind the products of which ordinarily constitute food for human consumption, the sales and purchases of these animals are already exempt from tax. Including these animals in this bill could cause confusion about whether sales of these animals are taxable if they aren’t use for fiber.
6. **Would any fowl or insects qualify as fiber animals?** In the “food animal” exemption, the Board has interpreted the statute to include as food animals certain fowl, such as turkey, chicken, and pigeons, and certain insects, such as bees. This bill specifies that the exemption would apply to any animal whose coat, fur, skin, or hair is used to create fibers. Is it the author’s intent to include, for example, waterfowl that may produce down within the proposed exemption (it could be argued that down is fur)? What about silkworms where silk is obtained from cocoons made by the larvae of the silkworm (many moth caterpillars shed the larval hairs that become part of the cocoon)? This should be clarified consistent with the author’s intent in order to avoid any future audit disputes.
7. **Why include oxygen?** The proposed language in the bill parallels Section 6358 which applies to food animals. In the proposed language, the bill includes oxygen within the types of drugs or medicines administered to animal life used in fiber production. Oxygen was incorporated into Section 6358 specifically for fish farming, as it is a vital element to sustain the fish and reduce stress and the onset of disease. It is unclear why oxygen would be included in the proposed exemption for fiber animals. Is oxygen used in to control disease in fiber animals?

COST ESTIMATE

Some administrative costs would be incurred in notifying affected retailers, amending the Board’s Regulation 1587, and answering inquiries. These costs are expected to be absorbable.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Alpacas

In a research article titled, “Alpaca Market in California,” the California Research Bureau indicated that about 99% of all alpacas in the U.S are registered, and those in the U.S without this distinction have minimal value as breeding stock, or when auctioned, and are extremely difficult to sell through private transactions. Further, U.S. registrations exceed 98,800. Ohio, with 12,725 registered animals, is the leading state in the U.S in alpaca population, followed by Washington, Oregon and California, with 6,530.

A 2005 research report, “Alpaca Lies: Do Alpacas Represent the Latest Speculative Bubble in Agriculture?” prepared by the Department of Agricultural and Resource Economics at the University of California, Davis, (UC Davis) discussed the costs of production for alpaca fiber. According to the report, the American Fiber Cooperative of

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North America estimated that the feeding, vaccination and general health requirements of the average alpaca raised in the U.S. were approximately \$169 annually. The researchers or authors of this report conducted their own study and estimated that feeding costs for an average alpaca was \$208 annually and estimated an additional \$100 per alpaca for health and vaccinations costs. Total estimated costs per alpaca was \$308. The health and vaccination costs reflect an estimated 32% of the total cost ($\$100 / \$308 = 32\%$).

We assume that, of the health and vaccination costs, about 20% would be related to actual purchases of drugs and medicine. This would adjust the two above-discussed annual costs to \$126 and \$228, respectively. If we take the average of both cost estimates, or \$177 per alpaca, and apply this to the 6,530 registered alpacas in California, total feeding and health (drugs, medicine) costs are estimated to be \$1.2 million ($\$177 \times 6,530 \text{ alpacas} = \1.2 million) annually.

According to the Alpaca Owners and Breeders Association, alpaca sales data is not available. The authors of the UC Davis report indicated that there was no systematic reporting of alpaca sales. According to the California Alpaca Breeders Association (Calpaca), non-breeding males are sold as pets or for use as fiber animals, and they generally sell for \$500 to \$1,000. In a survey pursued by Calpaca in April 2007, respondents indicated that they paid \$34,000 in sales and use tax for their purchases of alpacas. If we assume that half of these sales relate to fiber-producing alpacas, estimated annual sales for fiber-producing alpacas would be \$214,105 ($\$17,000 \text{ sales \& use tax} / 7.94\% \text{ average tax rate} = \$214,105 \text{ taxable sales}$).

Therefore, the estimated taxable sales attributable to fiber-producing alpacas that would be exempted by this measure amounts to \$1.4 million (\$1.2 million for feed, drugs and medicines + \$214,105 for alpacas).

Llamas

According to the International Llama Registry, a not-for-profit corporation that maintains llama genealogical information, as of April 2007, there were 158,663 llamas registered in the U.S. There were 12,384 llamas registered in California.

In discussions with a major ranch owner in Southern California, it was mentioned that most llama farms are in Southern California and that llamas are larger animals than alpacas, thereby consuming a greater proportion of food. Food would include grass, hay, supplements, salt and minerals. The cost is estimated to be \$24-39 a month. Vet costs vary, but an estimated \$100 a year is provided as a maintenance cost. We assume that about 20% of this amount, or \$20 a year, relates to drugs and medicines. Total feeding and health annual cost is estimated to be \$398 per llama.

In our discussions, it was also mentioned that not all llamas are purchased for fiber production; an estimated 20% would reflect llamas used for fiber production in California. Based on California's 12,384 registered llamas, it is estimated that 2,476 llamas are used for fiber production ($20\% \times 12,384 = 2,476$). It is estimated that total feeding and health (drugs, medicine) costs for llamas related to fiber production amount to \$985,448 ($\$398 \times 2,476 \text{ llamas} = \$985,448$).

Llamas sell from \$500 to \$5,000, depending on the animal. The average estimated price is \$1,500 for females and \$800 for males. Although California registrations of both

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animals (alpacas, llamas) to U.S registrations are similar (about 7%), alpacas are generally purchased for fiber production, and as indicated earlier, only an estimated 20% of llamas are purchased for fiber production. A Llama Registry survey revealed that only 7% of owners purchased llamas for fiber production. With these ratios, we assume that llama sales directly related to fiber production would not be significant.

Therefore, the estimated taxable sales attributable to fiber-producing llamas that would be exempted by this measure amounts to \$985,448.

Total Alpaca & Llama Sales

Total annual sales or purchases are estimated to be \$2.4 million (\$1.4 for alpacas + 985,448 for llamas).

REVENUE SUMMARY

The annual revenue loss from exempting \$2.4 million in sales of alpacas used in fiber production and sales of feed, drugs and medicines consumed and used by fiber-producing alpacas and llamas from the sales and use tax would be as follows:

	<u>Revenue Loss</u>
State loss (5%)	\$120,000
Fiscal Recovery Fund loss (0.25%)	6,000
Local loss (2.00%)	48,000
Special District loss (0.69%)	<u>17,000</u>
Total	<u>\$191,000</u>

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	04/17/07
Revenue estimate by:	Ronil Dwarka	(916) 445-0840	
Contact:	Margaret S. Shedd	(916) 322-2376	
Is			1050-1sw.DOC